

March 11, 2003

Preparer's Notice 03-03

To: Tax Preparers
From: Office of Revenue
Subject: Installment Sales

The following is intended as guidance in computing the income and tax liability resulting from installment sales entered into on or after January 1, 2001 and on or before June 30, 2003.

A taxpayer, regardless of the accounting method used, may not elect installment sales treatment in order to defer the recognition of income. However, the law does provide for a deferral of the tax payment provided the sale or other disposition of property is eligible for installment sales treatment for federal tax purposes and is in fact deferred for federal income tax purposes. If a taxpayer has not elected out of the installment method for federal tax purposes (IRC 453), the taxpayer will be considered to have made an election to defer the tax payment for state tax purposes. The taxpayer may elect out of the tax deferral by 1) attaching a statement of such to the return in the period of the sale, 2) recognizing all gain on any sales for the period, and 3) paying all taxes, interest, penalties, and assessments for the period in question.

Deferred Tax Payments:

Deferred tax payments are made on an installment basis as the proceeds are received. A deferred tax payment is made when gain equivalent to the tax due is included in Mississippi taxable income for the period in question and the resulting taxes paid. For the period of sale and each subsequent period the required deferred tax payment is computed by multiplying the total Mississippi gain by the ratio of proceeds received during the period to total sales proceeds. This resulting gain equivalent is added to the current period income. The resulting additional tax is the required deferred tax payment.

The following examples are for illustrative purposes only.

Example 1:

XYZ, Inc., a 100% Mississippi corporation, sold a plot of land with a tax basis of \$200,000 for \$1,200,000 in 2001 for a total gain of \$1,000,000. XYZ, Inc. received \$300,000 of the proceeds in 2001 and will receive the rest ratably over the next three years. XYZ, Inc. did not attach an election to pay all taxes on the gain in the year of sale. For XYZ, Inc. the gain equivalent and the amount of federal installment sales gain is the same, therefore, no return adjustments were required in the year of sale or later years of payment.

Example 2:

Corporation W sold a plot of land with a tax basis of \$200,000 for \$1,200,000 in 2001 for a total gain of \$1,000,000. W received \$300,000 of the proceeds in 2001 and will receive the rest ratably over the next three years. Corporation W is a multi-state taxpayer with an income apportionment ratio of 40% in 2001 (year of sale) and 10% in 2002. Ordinary income for 2001 is \$20,000 and for 2002 is <\$30,000>. Federal taxable income for 2001 is \$270,000 (\$20,000 ordinary and \$250,000 gain from the sale of land). Federal taxable income for 2002 is \$220,000 (\$30,000 of ordinary loss and \$250,000 gain).

Mississippi Taxable Income for 2001 is \$408,000, consisting of \$8,000 in ordinary income and \$400,000 ($1,000,000 \times 40\%$) from fully recognizing the gain from the installment sale with a resulting tax liability of \$20,250. If the tax payment is deferred, a gain equivalent is computed as follows: $(1,000,000 \times 40\% \times 300,000/1,200,000)$ or \$100,000. This amount is added to ordinary income (\$8,000), rather than actual gain recognized, in order to derive the required tax payment of \$5,250 on \$108,000 of Mississippi income. In 2002 another \$300,000 of the total proceeds are received, therefore a gain equivalent of \$100,000.00 ($1,000,000 \times 40\% \times 300,000/1,200,000$) is added to MS ordinary income {<\$3,000> ($\$30,000 \times 10\%$)} to arrive at taxable income of \$97,000.

If the Commissioner determines the income tax apportionment ratio for the period of sale in which the gain is recognized does not accurately reflect the correct gain, he may employ one or more prior income tax apportionment ratios or some other method that he believes will properly apportion such gain to this state. If, in the period of a sale, the taxpayer is solely taxable in this state, such deferred tax payments shall be apportioned fully to this state in all future periods. If, in the period of sale, the taxpayer is not taxable in this state or the gain is of a nonbusiness nature and the situs of such sale is outside this state, then such gain shall be fully taxed outside this state in the period of sale and all future periods. Gains from installment sales being taxed shall be included in full in the year of actual sale and shall not be included in any sales ratio in any reporting period other than in the year of actual sale. The fact that the property being sold is not located in this state shall not change the method of reporting for such installment sale.

A taxpayer will immediately recognize all deferred taxes i.e. "gain equivalent" in any of the following circumstances:

- 1) A taxpayer sells, contributes, transfers or disposes of the installment note in any manner.
- 2) A taxpayer dissolves, withdraws from this state, liquidates or merges into another entity and is not the survivor. All deferred gains shall be recognized and taxes paid on the taxpayers final return.
- 3) An entity, which has deferred taxes yet to be paid to this state, fails to make an income tax filing to this state on at least an annual basis. In such circumstances, all deferred tax payments are due in the period following the period, in which the entity last filed an income tax return.

The following shall apply to gains from installment sales made prior to January 1, 2001.

All gains from installment sales that for federal reporting purposes were made prior to December 17, 1999 shall continue to be apportioned or allocated and the gain taxed to this state in the manner that was employed in the period of such sale.

If a taxpayer realized a gain from the casual sale of property on the installment basis during the period December 17, 1999 through December 31, 2000, such gain shall be recognized in full in the year of sale. The provisions contained in H.R. 3594, Installment Tax Correction Act of 2000 (Federal law), for reporting the sale on the installment basis for federal purposes shall not be applicable for state income tax purposes. An amended return for the year of sale reporting such gain in full should be filed within 120 days from the effective date of this regulation, including full payment of any additional tax and interest due on the gain. Penalties may be abated in such cases.